RS650-2
3/1/89

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 5B
February 3, 1989

IN THIS ISSUE:

Japan's Trade Surplus Dips In 1988
But Worries Mount 1

Fiscal Review:
Revised FY 1988 General Account Budget 5

Fiscal Outlook: Initial FY 1989 Budget 7

Japan's Defense Budget Up Amid Calls
For Greater Allied Burdensharing 12

FY 1989 Budget Boosts Foreign Aid 13

Recruit Cosmos Cloud Hangs Over
Takeshita's Washington Trip 14

USTR And Commerce Heads Confirmed 16

Notes: Japanese Bond Market Investigation;
Tariff Cuts 17

Japan's Trade Surplus Dips In 1988 But Worries Mount

Everyone seems to agree that by the mid-1980s Japan's trade surplus had grown too large. So Japan's steady, if slow, progress over the past year or two in reducing the imbalance has been good news on both sides of the Pacific. The latest figures indicate that the trend continued in 1988, with the most widely watched measure -- the dollar-denominated trade surplus -- dropping 2.9 percent for the second annual decrease after peaking at $82.7 billion in 1986 (see Tables). This measure actually understated the improvement because the dollar's ongoing depreciation in 1988 exaggerated the measured increase in both imports and exports, thereby inflating the surplus as well. In yen terms the trade imbalance dropped 14.4 percent, reducing the surplus below 1985's level. As

measured in volume, imports soared 16.7 precent, easily exceeding the 4.4 percent rise in exports.

If the year's results were reason for encouragement, the quarterly figures were not. In the last two quarters of 1988 the dollar-denominated trade surplus grew over year-earlier levels and, in the October-December period, increased in yen terms as well. While imports by any measure remain remarkably healthy, exports have broken out of their long slumber, up 6.7 percent and 5.8 percent in volume in the two most recent quarters.

Foreign officials, fearing that the famed Japanese export juggernaut is back in business, are reacting warily and reexamining their thinking about the forces that shape international trade. Among their questions: what happened to the supposed power of exchange rate changes to erase large imbalances? While immediate relief was not expected, they say, progress in the three years that have elapsed since the Plaza Accord has been surprisingly modest, particularly since further improvement appears problematic.

One answer: exchange rates obviously matter, and the latest U.S. and Japanese trade figures provide supporting evidence. After a predictable lag, the dollar's depreciation since 1985 has cut both the U.S. deficit and the Japanese surplus, particularly when each is adjusted for currency realignment and price changes. And Japan's bilateral surplus with the United States has improved faster recently than the country's worldwide imbalance, dropping 8.6 percent in dollars and 19.4 percent in yen in 1988.

But exchange rate changes alone cannot do the job. Economic growth counts, too. Last year gross national product in the United States -- Japan's largest trading partner -- grew a real 3.8 percent. Given the traditionally strong relationship between growth in the United States and shipments from Japan, Japanese export sales in this country would have been much stronger in the absence of exchange rate changes. Growth in Japan, and the increased imports that expansion implies, probably would not have offset this surge. In this context, the reduction in the bilateral surplus has to be counted as an accomplishment for which currency realignment deserves much of the credit.

Some Japanese experts make a related argument. In a free market economy like Japan's, officials can, at most, influence Japanese firms and consumers to buy more foreign products. Partly as a response to just such prodding, imports are soaring. But Japanese officials have no leverage over U.S. consumers, who continue to buy imported products in large quantities, higher prices notwithstanding. If anybody can get the message to the American public, it is the U.S. government, which has chosen not to do so. Until Washington cuts the federal budget deficit or takes other actions to rein in demand, Japanese imports will have to bear most of the adjustment burden. This, in turn, implies slow progress on the bilateral and the worldwide Japanese trade surpluses.

Officially, Tokyo believes that the worldwide trade surplus will continue dropping, if not every quarter, at least over longer periods of time. Its recently released economic outlook forecasts that the dollar-denominated trade surplus on a balance of payments basis for the fiscal year beginning April 1 will decline 5.4 percent from FY 1988's projected total (JEI Report No. 4B, January 27, 1989). Other forecasters are much less sanguine. The Long-Term Credit Bank, Ltd. is among the most pessimistic, predicting that the surplus will jump 17.8 percent in FY 1989. But even the bank's forecast shows that import growth on a gross national product basis will exceed export growth, implying that net exports will still be a drag on the Japanese economy.

Japan's Total Trade in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	$170,114	15.8%	$136,503	8.0%	$33,611
1985	175,638	3.2	129,539	-5.1	46,099
1986	209,151	19.1	126,408	-2.4	82,743
1987	229,221	9.6	149,515	18.3	79,706
1988 (p)	264,867	15.6	187,475	25.4	77,392
1986: I	45,499	18.2	33,005	1.5	12,494
II	53,166	21.5	31,424	-2.1	21,742
III	54,768	24.7	30,153	-3.5	24,615
IV	55,718	12.6	31,826	-5.5	23,892
1987: I	51,464	13.1	31,977	-3.1	19,487
II	56,931	7.1	36,380	15.8	20,551
III	57,855	5.6	38,346	27.2	19,509
IV	62,972	13.0	42,812	34.5	20,159
1988: I	60,296	17.2	44,499	39.2	15,797
II	65,184	14.5	47,331	30.1	17,853
III	67,188	16.1	47,344	23.5	19,844
IV (p)	72,199	14.7	48,301	12.8	23,898

Japan's Total Trade in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	Y40,325	15.5%	Y32,321	7.7%	Y8,004
1985	41,956	4.0	31,085	-3.8	10,871
1986	35,290	-15.9	21,551	-30.7	13,739
1987	33,315	-5.6	21,737	0.9	11,578
1988 (p)	33,933	1.9	24,022	10.5	9,911
1986: I	8,674	-12.4	6,334	-24.1	2,339
II	9,119	-17.3	5,399	-33.3	3,720
III	8,632	-18.5	4,758	-36.8	3,874
IV	8,865	-15.1	5,060	-28.9	3,806
1987: I	7,960	-8.2	4,959	-21.7	3,002
II	8,153	-10.6	5,207	-3.6	2,946
III	8,507	-1.5	5,644	18.6	2,864
IV	8,694	-1.9	5,928	17.2	2,767
1988: I	7,715	-3.1	5,687	14.7	2,028
II	8,164	0.1	5,927	13.8	2,237
III	8,927	4.9	6,292	11.5	2,635
IV (p)	9,127	5.0	6,117	3.2	3,010

Japan's Trade with the United States in Dollar Terms

(in millions of dollars)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	$59,937	39.9%	$26,862	9.0%	$33,075
1985	65,278	8.9	25,793	-4.0	39,485
1986	80,456	23.3	29,054	12.6	51,401
1987	83,580	3.9	31,491	8.4	52,090
1988 (p)	89,612	7.2	42,000	33.4	47,613
1986: I	16,696	25.1	6,278	-7.3	10,418
II	20,921	24.3	8,305	25.1	12,616
III	21,280	28.1	7,525	23.1	13,755
IV	21,559	16.7	6,946	10.8	14,613
1987: I	18,001	7.8	6,986	11.3	11,015
II	21,181	1.2	7,592	-8.6	13,589
III	21,628	1.6	8,252	9.7	13,376
IV	22,770	5.6	8,660	24.7	14,110
1988: I	19,859	10.3	10,088	44.4	9,772
II	21,608	2.0	10,451	37.7	11,157
III	23,060	6.6	10,664	29.2	12,396
IV (p)	25,084	10.2	10,797	24.7	14,287

Japan's Trade with the United States in Yen Terms

(in billions of yen)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1984	Y14,221	39.7%	Y6,364	8.7%	Y7,858
1985	15,583	9.6	6,213	-2.4	9,369
1986	13,564	-13.0	4,918	-20.9	8,646
1987	12,148	-10.4	4,582	-6.8	7,566
1988 (p)	11,485	-5.5	5,384	17.5	6,101
1986: I	3,191	-6.9	1,203	-30.7	1,988
II	3,589	-15.4	1,421	-15.1	2,168
III	3,355	-16.3	1,190	-19.3	2,165
IV	3,429	-12.1	1,104	-16.9	2,325
1987: I	2,786	-12.7	1,083	-9.9	1,703
II	3,034	-15.5	1,086	-23.6	1,948
III	3,180	-5.2	1,215	2.1	1,965
IV	3,148	-8.2	1,198	8.5	1,950
1988: I	2,541	-8.8	1,290	19.1	1,251
II	2,706	-10.8	1,308	20.5	1,398
III	3,064	-3.6	1,417	16.7	1,647
IV (p)	3,174	0.8	1,368	14.1	1,806

But Washington is not likely to pay much attention to such complicated, if meaningful, statistics, preferring to focus on Japan's dollar-denominated trade surplus, which by all accounts is expected to remain at historically high levels a year from now. Even by the Japanese government's reckoning, the FY 1989 surplus will be the third-largest on record. At least one forecast for the coming year seems safe enough: Japan's plethora of trade statistics will continue to support widely differing views on the direction of its foreign trade.

Douglas Ostrom

Fiscal Review: Revised FY 1988 General Account Budget

Tokyo put the finishing touches on an apparently successful fiscal plan for FY 1988 by approving a large supplemental appropriation to the general account budget. The January 19 action will bring total general account outlays for the year ending March 31, 1989 to just under Y61.9 trillion ($495.2 billion at Y125=$1.00), a 6.2 percent increase over the revised FY 1987 budget.

The supplement was approved later than usual because of the government's lengthy (and ultimately successful) effort to win Diet approval of a controversial tax reform package (see JEI Report No. 1B, January 6, 1989). This delay and the desire to press ahead with compilation of the budget for FY 1989 (see following article) showed up in the hurried supplemental spending calculations first offered by the Ministry of Finance. MOF's initial guideline added up to just over Y4.7 trillion ($37.6 billion). A closer look revealed two factors that enabled the ministry to raise the additional spending program to just under Y5.2 trillion ($41.6 billion): tax revenues are projected to be much larger than expected, as is the budget surplus to be carried over from FY 1987 (see Table). Current predictions put tax revenues in FY 1988 11.6 percent higher than in the April 1987-March 1988 period, well above the initial estimate of 9.5 percent. And the carryover from FY 1987 is 27.1 percent bigger than what was left over from the FY 1986 budget.

Together, these two windfalls will allow MOF to cut issues of deficit-financing bonds by Y1.4 trillion ($11.2 billion) to Y1.8 trillion ($14.4 billion) for the entire fiscal year. This is nearly half of the initial projected borrowing of Y3.2 trillion ($25.6 billion). At the same time, issues of construction bonds will amount to Y6.2 trillion ($49.6 billion), a rise of Y506 billion ($4 billion). Despite this, a net decrease in total bond issues is still visible in the full-year figure. The ratio of total bond issues to total general account spending is expected to drop to 12.9 percent in the revised FY 1988 budget. The decline from the initial 15.6 percent level is due mainly to the lower dependence on deficit-financing bonds, 2.9 percent rather than 5.5 percent.

Although a major portion of the supplementary funds must be transferred to local governments under revenue-sharing rules, outlays for social security, public works and foreign aid will receive a boost. In addition to the Y90 billion ($720 million) directed at increasing trade insurance (mainly for imports from developing countries), a total of Y24.6 billion ($196.8 million) is included (in the "other" entry under miscellaneous outlays) to back Prime Minister Noboru Takeshita's commitments to the United Nation's peacekeeping forces and to support international refugee assistance programs. Money also was set aside to help Japanese farmers adjust to the coming liberalization of beef and

FY 1988 Initial, Supplemental and Revised General Account Budget

(in billions of yen)

Initial FY 1988 (affected categories only)		Supplemental FY 1988		Revised FY 1988
Revenues				
Taxes	Y45,090.0	Taxes	Y3,016.0	Y48,106.0
Non-tax Revenues	1,468.7	Non-tax Revenues	35.5	1,504.2
Bonds	8,841.0	Bonds	-874.0	7,967.0
Construction	5,690.0	Construction	506.0	6,196.0
Deficit Financing	3,151.0	Deficit Financing	-1,380.0	1,771.0
		Carryover from FY 1987	2,974.5	2,974.5
		Expenditures	1,893.7	
		Transfers to Local Governments	1,080.8	
Total	56,699.7	Total	5,152.0	61,851.7
Expenditures				
Transfers to Local Governments	10,905.6	Transfers to Local Governments	2,125.6	13,031.2
		FY 1987 Surplus	1,080.8	
		FY 1988 Natural Increase	1,044.8	
Social Security	10,384.5	Public Welfare Insurance	1,507.8	11,892.3
Public Works	6,082.4	Public Works	598.0	6,680.4
Disaster Relief	65.1	Disaster Relief	418.6	483.7
Housing Development	750.9	Housing & Urban Development Corp.	179.4	930.3
Food Control Programs	448.2	Agricultural Import Liberalization	104.6	552.8
Economic Cooperation	682.2	Trade Insurance	90.0	772.2
Miscellaneous Outlays	3,939.8	Miscellaneous Outlays	-220.9	3,718.9
		Wage Increases	144.4	
		Consumption Tax Introduction	162.5	
		Miscellaneous Reductions	-750.0	
		Other*	222.2*	
		National Debt Redemption	946.9	946.9
Total	56,699.7	Total	5,152.0	61,851.7

*Includes Y24.6 billion for United Nations peacekeeping forces and refugee assistance.

orange imports, and funds were earmarked to ease the introduction of the recently approved 3 percent consumption tax.

The FY 1988 supplemental budget is a whopping 25.3 percent larger than the addition approved for the previous fiscal year. Whether Tokyo will continue to enjoy such good fortune is a matter of debate and concern among policymakers. The poor performance of revenue projections is of particular interest. On the one hand, uncertainties generated by two years of trying to make major changes in Japan's tax system may have confused the outlook. On the other, it appears that estimates of economic and financial market activity were simply too conservative. In either case, Tokyo cannot rely on similar windfalls in future years but is certainly taking full advantage while they last.

Jon Choy

Fiscal Outlook: Initial FY 1989 Budget

A projected boom in tax revenues will allow Tokyo to expand spending 6.6 percent to Y60.4 trillion ($483.3 billion at Y125=$1.00) in the year beginning April 1 while simultaneously reducing deficit financing. The cabinet of Prime Minister Noboru Takeshita approved a 1989 fiscal plan January 24 that differs from a Ministry of Finance draft (see JEI Report No. 4B, January 27, 1989) in two important areas: defense and foreign aid (see articles in this issue). From a macroeconomic standpoint, the cabinet considers the package to be marginally stimulative. Tokyo also is seeking significant tax changes that could spur consumer demand and reduce trade tensions.

Growth in the overall general account budget for FY 1989 is pegged at 6.6 percent, the biggest jump in eight years (see Table 1). Total discretionary spending will rise a smaller 3.3 percent, but this is still nearly three times the increase allowed initially in the current fiscal year. The budget writers' mood is clearly moving away from austerity: only four of the 13 discretionary allotments show zero or negative growth for FY 1989, compared with seven program areas in FY 1988. Although energy measures lead the way with a 14.3 percent surge, this is the category's first increase in several years and still leaves spending well below its FY 1982 level. Outlays for foreign aid show the next greatest percentage increase (6.7 percent), followed by defense (5.9 percent), social security (4.9 percent), miscellaneous expenses (3 percent) and disaster relief (2.5 percent). Unlike previous years, allocations for public works (1.9 percent) and education and science (1.6 percent) show minimal growth. The economy has had some difficulty absorbing the large increase in public works expenditures budgeted in the current fiscal year to the point where officials were concerned about inflation.

Hidden in the overall FY 1989 budget figures are some interesting features:

Public Works - Spending for roads will rise 2 percent to Y2,171.7 billion ($17.4 billion), while outlays for sewer and water systems will climb 2.6 percent to Y823.4 billion ($6.6 billion). Funds for airport and harbor development also will rise 2.1 percent to Y102.2 billion ($817.6 million).

Housing - Money for building new homes will rise to Y841.6 billion ($6.7 billion), a 2 percent increase. The government-owned Housing Loan Corp. will back loans for an estimated 54,500 homes in FY 1989, representing a 1.5 percent increase in commitments.

Social Welfare - A 5.6 percent increase in average annual welfare benefits is planned, while government pensions will rise 6.2 percent. Smaller increases for medical insurance and unemployment compensation are scheduled. A 4.2 percent rise in public health outlays also is projected.

Education - Support for students at public universities will jump 13.2 percent, while those in secondary school will receive a 14.4 percent increase. Subsidies for private institutions will rise 2.7 percent for primary education and 1.3 percent at the college level.

Science - To support Japan's contributions to the international science community, Y2.4 billion ($19.2 million) has been set aside for the Human Frontier Program. The program, initiated by ex-Prime Minister Yasuhiro Nakasone in 1987, is aimed at understanding basic biological functions through cooperative international research.

Transportation - A total of Y6.8 billion ($54.4 million) will be directed toward surveys and construction of three new high-speed rail lines (the famous "bullet" trains, Shinkansen). This is the first appropriation for the three projects, which originally were laid out in a 1973 law. The three extensions will take seven years to complete.

Table 1: Summary of General Account Outlays, FY 1988-FY 1989

(in billions of yen; change from initial FY 1988 budget)

	FY 1988	FY 1989	Change
Discretionary Items			
Social Security	Y10,384.5	Y10,894.7	4.9%
Education and Science	4,858.1	4,937.1	1.6
Pensions	1,879.8	1,855.8	-1.3
Defense	3,700.3	3,919.8	5.9
Economic Cooperation	682.2	727.8	6.7
Public Works	6,017.3	6,130.7	1.9
Disaster Reconstruction	65.1	66.7	2.5
Small Business Measures	195.2	194.2	-0.5
Food Control Programs	448.2	418.2	-6.7
Energy Measures	461.6	527.5	14.3
Other	3,939.8	4,058.1	3.0
Reserves	350.0	350.0	0.0
Total	32,982.1	34,080.5	3.3
Nondiscretionary Items			
Transfers to Local Governments	10,905.6	13,368.8	22.6
Debt Service	11,512.0	11,664.9	1.3
Transfer of NTT Proceeds to Public Works	1,300.0	1,300.0	0.0
Total	23,717.6	26,333.7	11.0
Total	56,699.7	60,414.2	6.6

The reason for this relaxed fiscal stance is clear when the revenue side of the budget is examined (see Table 2). After underestimating tax receipts for several years, the Finance Ministry has penciled in a 13.1 percent increase for

FY 1989. Although the recently passed 3 percent consumption tax is projected to raise some Y3 trillion ($24 billion), MOF expects that booming corporate levies will provide most of the increase. The tax windfall will allow Tokyo to cut borrowing to finance current expenditures by a whopping Y1.8 trillion ($14.6 billion) to just Y1.3 trillion ($10.7 billion). Combined with a nominal Y90 billion ($720 million) increase in construction bonds, borrowing will decline to 11.8 percent of the total budget, well below FY 1988's initial 15.6 percent ratio. Tokyo should have no trouble meeting its FY 1990 deadline to eliminate all new issues of deficit-financing bonds.

Table 2: Summary of General Account Revenue Estimates, FY 1988-FY 1989

(in billions of yen; change from initial FY 1988 budget)

	FY 1988	FY 1989	Change
Tax and Stamp Receipts	Y45,090.0	Y51,010.0	13.1%
Non-tax Receipts	1,468.7	993.2	-32.4
Proceeds from Sale of NTT shares	1,300.0	1,300.0	0.0
Bonds	8,841.0	7,111.0	-19.6
Construction	5,690.0	5,780.0	1.6
Deficit Financing	3,151.0	1,331.0	-57.8
Total	56,699.7	60,414.2	6.6

The Fiscal Investment and Loan Program, a separately financed capital budget, will grow by 9 percent in FY 1989, slightly less than the current year's 9.4 percent initial increase (see Table 3). The plan echoes Tokyo's mixed stance toward increasing public works spending. FILP's public works appropriations feature largesse for general infrastructure (38.9 percent), transportation and communications (5.9 percent) and roads (2.6 percent) but cutbacks

Table 3: Fiscal Investment and Loan Program Outlays, FY 1988-FY 1989

(in billions of yen; change from initial budget of previous year)

	FY 1988		FY 1989	
	Amount	Change	Amount	Change
Housing	Y6,921.5	9.4%	Y7,460.6	7.8%
Public Service Facilities	4,450.9	11.3	4,371.3	-1.8
Welfare	661.8	5.4	736.0	11.2
Education	637.6	-18.7	520.2	-18.4
Small Business	4,030.6	1.1	4,176.4	3.6
Agriculture	979.4	7.9	924.4	-5.6
Land Conservation and Disaster Reconstruction	409.8	-16.9	357.9	-12.7
Roads	2,512.1	6.3	2,576.8	2.6
Transportation and Communications	2,229.9	1.5	2,361.6	5.9
Regional Development	652.2	-0.8	676.6	3.7
Industry and Technology	687.2	8.9	758.7	10.4
Trade Promotion and Economic Cooperation	1,171.0	69.6	1,420.0	21.3
Capital Utilization	4,270.0	27.6	5,930.0	38.9
Total	29,614.0	9.4	32,270.5	9.0

in land conservation and disaster relief (-12.7 percent) and public service facilities (-1.8 percent). The FILP budget clearly continues to make up for deficiencies in the general account budget. Strong gains are planned for industry and technology development (10.4 percent), social welfare (11.2 percent) and housing (7.8 percent). One area where both spending plans agree is foreign aid: trade promotion and economic cooperation will grow by 21.3 percent.

In terms of FILP fund sources (see Table 4), it is clear that the role of the general account (through transfers via the Industrial Investment Special Account) continues to shrink. Reliance on funds collected through the postal savings system eventually will come into conflict with Japan's efforts to liberalize its financial markets. Reform or restructuring of the postal savings system must go hand in hand with further financial liberalization, raising questions about long-term FILP funding.

Table 4: Fiscal Investment and Loan Program Sources, FY 1988-FY 1989

(in billions of yen; change from initial budget of previous year)

	FY 1988		FY 1989	
	Amount	Change	Amount	Change
Industrial Investment Special Account	Y91.2	-36.8%	Y85.2	-6.6%
Trust Fund Bureau	26,206.6	6.5	26,871.3	2.5
Postal Savings	7,900.0	0.0	8,500.0	7.6
Pension Contributions	3,500.0	-21.3	4,310.0	23.1
Other Revenues	14,806.6	20.9	14,061.3	-5.0
Postal Life Insurance Fund	4,409.4	11.9	5,614.0	27.3
Government-Guaranteed Bonds and Borrowings	2,406.8	2.8	2,000.0	-16.9
Total	33,114.0	6.5	34,570.5	4.4

The degree to which Tokyo can "have its cake and eat it too" by reducing the general account deficit while raising spending is apparent when MOF's proposed budget and the cabinet-approved version are compared (see Table 5). While MOF held to the practice of staying within the total amount initially proposed, a block of unallocated funds was included in its proposal from the start. In previous years funds from other categories were shifted to boost defense and foreign aid outlays. In this budget every category except miscellaneous expenses was increased or held steady in the cabinet-approved version. This embarrassment of riches has generated calls for tax changes from the government and the ruling Liberal Democratic Party despite the exhausting tax reform battle that was just ended.

The LDP and the government Tax Research Councils have proposed tax reductions worth an estimated Y290.6 billion ($2.3 billion) for FY 1989. Many are aimed at reducing the impact of the 3 percent consumption tax on lower income families and include: increasing deductions for elderly dependents (Y910,000 or $7,280 a year versus the current Y720,000 or $5,760), raising the amount of tax-exempt income for fatherless families by Y120,000 ($960) to Y350,000 ($2,800), and allowing bigger deductions for commuting expenses (Y50,000 or $400 a month versus the current Y26,000 or $208). Some energy and utility taxes also may be reduced. Of particular interest to consumers and foreign automotive makers is a proposal to cut the local taxes on cars with engines displacing 2,000 cc or more. The changes could translate into tax

reductions of up to 45 percent and could add fuel to the boom in luxury car sales.

Table 5: Comparison of Proposed and Approved FY 1989 Discretionary Outlays

(in billions of yen)

	Proposed	Approved
Social Security	Y10,847.8	Y10,894.7
Education and Science	4,862.8	4,937.1
Pensions	1,828.2	1,855.8
Defense	3,892.7	3,919.8
Economic Cooperation	718.8	727.8
Public Works	6,130.7	6,130.7
Disaster Reconstruction	66.7	66.7
Small Business Measures	189.8	194.2
Food Control Programs	415.3	418.2
Energy Measures	523.4	527.5
Other	4,174.2	4,058.1
Reserves	350.0	350.0
Unallocated Expenses	80.0	--

Tokyo intends to make up for some of these reductions by squeezing large corporations. Companies with incomes of over Y1 billion ($8 million) could face a 1 percent increase in marginal corporate tax rates. Measures involving tax-free reserves and accounting for overseas operations also are being examined.

Some tax changes are directed at goals other than revenue production. To promote new public parks and facilities, one proposal would raise the maximum tax-exempt value of land transferred from private to public ownership from Y30 million ($240,000) to Y50 million ($400,000). In an effort to dissuade exports, the reserve for overseas market development by small enterprises may be scaled back. Companies with a capital of Y100 million to Y500 million ($800,000 to $4 million) currently can set aside 0.176 percent of the export value of goods purchased from others and 0.244 percent of all other transactions as a tax-free reserve. (Firms capitalized at less than Y100 million have more generous rates of 1.04 percent and 1.41 percent, respectively.) These rates could be reduced to 0.16 percent and 0.22 percent, respectively (1 percent and 1.3 percent for smaller firms). Taxes on imports of crude oil also face reduction from Y530 ($4.24) per kiloliter to Y350 ($2.80) per kiloliter, while those on heavy fuel oil will be increased by 70 percent to 123 percent.

The cabinet hopes to submit the approved spending plans to the Diet between February 8 and 10. Although there is some opposition resistance to the boost in defense spending (the increase keeps this category above 1 percent of projected gross national product), the budget is likely to win Diet approval without much difficulty. The government's tax plan also stands a good chance of sailing through the Diet with ease if it does indeed focus on addressing adverse consequences of last year's tax system overhaul.

Jon Choy